FEDERAL RESERVE press release

For Use at 4:30 p.m. November 17, 1989

The Federal Reserve Board and the Federal Open Market Committee today released the attached record of policy actions taken by the Federal Open Market Committee at its meeting on October 3, 1989.

Such records for each meeting of the Committee are made available a few days after the next regularly scheduled meeting and are published in the Federal Reserve Bulletin and the Board's Annual Report. The summary descriptions of economic and financial conditions they contain are based solely on the information that was available to the Committee at the time of the meeting.

Attachment

RECORD OF POLICY ACTIONS OF THE
FEDERAL OPEN MARKET COMMITTEE

Meeting Held on October 3, 1989

Domestic policy directive.

The information reviewed at this meeting suggested that economic activity continued to expand at a moderate pace in the third quarter and that rates of resource utilization remained at relatively high levels. Aggregate final demand appeared to be well sustained by a pickup in consumption at a time of somewhat reduced growth in business fixed investment. At the same time, price inflation had slowed, in large part because of a steep drop in energy costs and a continuing decline in prices of non-oil imports; wage data evidenced no deviation from recent trends.

Growth in total nonfarm payroll employment slowed noticeably in July and August from the pace of the second quarter. Nevertheless, adjusted for the depressing effects of strike activity, job gains remained appreciable on balance. Hiring was brisk in construction, trade, and services; in manufacturing industries, though, employment levels generally held steady or fell a bit, apart from temporary fluctuations in the auto industry. The civilian unemployment rate remained around 5-1/4 percent.

Industrial production rose in August, and revisions for earlier months suggested that the expansion of production had not been as weak as previously estimated. Much of the August gain reflected a rebound in automobile production after three months of decline and a pickup in coal mining as striking coal miners returned to work. Output of consumer goods other than autos edged down in August with small but widespread

declines in nondurable goods. Despite a sizable jump in operating rates for coal mining, total industrial capacity utilization was unchanged in August at a relatively high level. In manufacturing, factory utilization edged further below its January peak, partly as a result of additional declines in primary processing industries, such as paper and chemicals, where utilization had been very high.

Consumer spending rose substantially in August, following a July increase that was somewhat larger than the sluggish gains of previous months. Much of the August pickup reflected a surge in outlays for cars and light trucks, but gains in spending for goods and services other than motor vehicles also appeared to be running somewhat above the relatively sluggish pace for the second quarter. Housing starts in July and August were slightly higher than their second-quarter average, and sales of new homes picked up noticeably in July. However, building permits had shown no discernible trend in recent months.

Recent indicators of business capital spending suggested somewhat slower growth in the third quarter after a substantial increase in the first half of the year. In July and August, shipments of nondefense capital goods excluding aircraft were only a little above the second-quarter level, and orders data suggested a further slowing in growth of spending in coming months. In July, office building remained a notable area of weakness in nonresidential construction and partially offset another strong rise in outlays for industrial structures. Inventory investment in manufacturing moderated in August after a sizable increase in July, with much of the increase in both months occurring at aircraft firms. In July, stocks also rose markedly at

manufacturers of primary metals and of many types of machinery; the buildup at these industries, like that at aircraft firms, was concentrated in work-in-process. Excluding motor vehicles and aircraft, manufacturing stocks remained at relatively low levels compared with shipments. At the retail level, increases in inventories slowed in July and imbalances with sales remained limited.

The nominal U.S. merchandise trade deficit recorded a further decline in July relative to June and to the average for the second quarter as a whole. Exports in July fell below their strong June level and were little changed from the second-quarter average. While most categories of exports fell, deliveries of civilian aircraft increased sharply. Imports registered a further decline in July, as decreases in most categories of non-oil goods outweighed a small rise in the value of oil imports. Economic growth in the major foreign industrial countries slowed sharply in the second quarter from the very rapid rate of the first quarter, but this pattern appeared to be due largely to special factors rather than to a slackening of the underlying pace of activity.

Producer prices of finished goods declined in August for the third consecutive month, reflecting a further large drop in consumer energy prices; for the July-August period, price increases for nonfood, non-energy finished goods moderated from the pace of earlier months of the year. At earlier processing stages, prices of intermediate materials other than food and energy edged down further in August and had registered little net change over the previous six months, while prices of crude nonfood materials other than energy turned up after four months of declines. Consumer prices were unchanged in August following

a small increase in July. Sharp reductions in energy prices and smaller increases for food items helped damp the rise in consumer prices in July and August, but prices for other consumer goods also rose more slowly. Average hourly earnings slipped a little in August after a sizable jump in the previous month, but on a year-over-year basis this decline did not indicate a change in trend.

At its meeting on August 22, the Committee adopted a directive that called for maintaining the current degree of pressure on reserve positions and that provided for giving special weight to potential developments that might require some slight easing during the intermeeting period. The Committee agreed that, in furtherance of the ultimate achievement of price stability, primary weight in considering the need for intermeeting changes in reserve conditions would continue to be given to the inflation outlook. Slightly greater reserve restraint might, or slightly lesser reserve restraint would, be acceptable in the intermeeting period depending on progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The contemplated reserve conditions were expected to be consistent with growth of M2 and M3 over the period from June through September at annual rates of about 9 and 7 percent, respectively.

Reserve conditions remained essentially unchanged over the period since the August meeting. Adjustment plus seasonal borrowing averaged about $550 million for the two full reserve maintenance periods since the meeting, and federal funds traded mostly in the narrow range around 9 percent that had prevailed since late July. With federal funds

rates steady and economic data released over the intermeeting period generally in line with market expectations, other interest rates changed little on balance over the intermeeting period. Some softening in interest rates took place through mid-September, owing at least partly to a market view that an easing of monetary policy might be in the offing given the strengthening dollar, but when the dollar subsequently declined against other G-10 currencies, interest rates generally rebounded. Most stock market indexes reached record highs in early September but partially retraced their increases as problems emerged in the "junk bond" market for a few prominent issuers.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies rose substantially early in the intermeeting period; better-than-expected U.S. job growth in August and U.S. trade data for July outweighed the effects of a slight decline in U.S. interest rates and some increase in rates abroad. The dollar fell sharply after the release on September 23 of the G-7 statement that the rise of the dollar in recent months was inconsistent with longer-run fundamentals, and the ensuing coordinated central-bank intervention in exchange markets. Also contributing to the slippage of the dollar were growing market expectations of some tightening of monetary policies abroad. On balance, the dollar depreciated somewhat over the intermeeting period.

Growth of the monetary aggregates slowed in August from their advanced July rates, which likely had been boosted by the replenishment of balances used to pay taxes last spring; their slower growth evidently carried over to September. Despite its deceleration, M2 still grew

fairly briskly in August and apparently also in September, bringing its expansion thus far this year to somewhat above the lower end of the Committee's annual range. Continued rapid growth of the retail components of M2 reflected in part the lagged effects of earlier declines in market interest rates. M3 increased at a substantially reduced pace over the August-September period, and it had expanded for the year to date at a rate around the lower bound of the Committee's annual range. The sluggish growth of M3 apparently was related in part to the declining needs of S&Ls for managed-liability funds; under-capitalized institutions were shrinking their balance sheets as a means of complying with new, more stringent capital standards, and insolvent institutions were receiving funds from the Resolution Trust Corporation (RTC).

The staff projection prepared for this meeting suggested that the nonfarm economy was likely to grow over the remainder of 1989 at about the pace estimated for the first half of the year but that the expansion would slow in 1990. The projection assumed that fiscal policy would remain moderately restrictive and that the contribution of foreign trade to growth would be very limited, owing in part to the earlier appreciation of the dollar. Consumer demand was expected to be bolstered in the near term by continued growth in labor income and the positive effect on real purchasing power of the recent slowing of price increases, but over the rest of the projection period steadily mounting slack in labor markets would exert a restraining effect on real income and consumer demand. Declines in interest rates earlier in the year were expected to provide some temporary stimulus to residential

construction activity over the next quarter or so. Expansion in business capital spending was projected to moderate substantially over the projection period from the pace in the first half of the year as output growth slowed, capacity pressures eased, and profits eroded. The recent weakening in food and energy prices pointed to a slower rise in consumer prices for the next few quarters; however, with margins of unutilized labor and other production resources still low, the underlying trend in inflation was not expected to show much improvement.

In the Committee's discussion of the economic situation and outlook, members commented that current indicators of business activity, including economic conditions in different parts of the country, presented a somewhat mixed picture. On the whole, however, members generally viewed the evidence as pointing to sustained expansion over the next several quarters, though many expected economic growth to slow somewhat from its recent pace. In assessing the chances of a different outcome, the members did not rule out the possibility of a slightly stronger economic performance, but they generally felt that the risks were tilted toward marginally greater slowing and a few expressed concern that a more pronounced weakening could emerge. With regard to the outlook for inflation, many commented that, given moderate economic growth and a sustained period of monetary restraint, underlying inflationary pressures were likely to ease a little over the next several quarters, but some anticipated somewhat greater progress in reducing inflation. Concern was expressed by some, however, that wage-cost pressures might intensify. The members agreed that progress against inflation would depend importantly on the behavior of the dollar

in foreign exchange markets; a very substantial decline in the value of the dollar would put upward pressure on prices and make achievement of the Committee's price stability objective correspondingly more difficult.

With regard to developments in specific sectors of the economy, members commented that a key uncertainty in the business outlook related to the prospects for capital expenditures. Growth in such spending had slowed from a very high rate in the first half of the year, and it was not clear from the recent data whether business investment was weakening further or whether its growth had stabilized at a reduced pace. New orders for capital equipment had softened, but order backlogs remained substantial and suggested continued high levels of production for many firms. On the other hand, indications of declining business profits together with the financial difficulties of a number of firms pointed to more restrained investment spending. The key to actual capital spending, of course, would be the evolving demand for goods and services and in that regard consumer spending, while subject to some volatility stemming especially from purchases of motor vehicles, was likely to continue to provide support for sustained growth. Business inventories, with some notable exceptions such as stocks of motor vehicles, were reported to be at acceptable levels and were not likely to contribute to wide swings in production unless final demands differed greatly from current expectations. The members were more uncertain about the outlook for housing and net exports. In the housing sector, considerable weakness had emerged in several parts of the country, and some members questioned whether any improvement could be expected over the next

several quarters even though interest rates had fallen since last spring. With regard to the prospects for foreign trade, the dollar's appreciation this year had retarded improvement in the trade balance and, barring a substantial real depreciation, was expected to continue to do so for some time. It was presumed that fiscal policy would remain moderately restrictive, but that there would be no dramatic turn in the federal budget deficit of the sort that would substantially reduce demand pressures in the domestic economy while accommodating significant improvement in the trade deficit.

In the Committee's discussion of the outlook for inflation, members observed that the recent improvement largely reflected a number of special factors--such as developments in the food and energy sectors and the appreciation of the dollar this year--that could not be projected to recur. Several saw only limited prospects for further improvement over the year ahead, given their expectations with regard to the overall performance of the economy and related pressures on resources. Others felt that the behavior of prices and wages might continue to be better than had been expected. They noted that reduced monetary growth over an extended period was continuing to restrain inflationary pressures and that the economy also was benefiting from ongoing cost-reducing measures induced by strong competition in domestic and international markets. A tendency for the prices of many commodities and intermediate materials to soften, if only marginally, also supported a relatively optimistic outlook for inflation. Moreover, there was a continuing pattern of restraint in labor settlements despite tight labor markets in many areas. Reflecting demographic factors,

upward pressures on wages tended to be concentrated on entry-level jobs, while pressures in many of the more skilled job categories appeared to have diminished in various parts of the country. However, some members expressed concern that faster wage increases remained a threat, especially if the economy continued to operate at levels close to its potential.

In the Committee's discussion of monetary policy for the intermeeting period ahead, most of the members endorsed a proposal to maintain unchanged conditions of reserve availability and preferred or found acceptable a suggestion to retain the asymmetry toward ease that was incorporated in the latest directive. While noting that developments in the near term might alter the economic outlook, most members felt that prevailing conditions in the domestic economy did not warrant a policy change in either direction at this time. The focus of policy continued to be that of gradually reducing inflation over time and a steady policy course seemed consistent with that objective, at least for now.

Members also were concerned that an easing of policy so soon after the G-7 meeting would be misinterpreted as an attempt to use monetary policy to force the dollar lower. While the dollar was an important factor influencing the course of the U.S. economy and prices, monetary policy should not be used, in the judgment of the Committee, to attain particular levels for the foreign exchange value of the dollar that could conflict with domestic policy objectives. In current circumstances, an easing might well provoke an undesirable sharp decline in the external value of the dollar. The members also discussed the

recent substantial intervention by G-7 and other nations against the dollar. Some members expressed concern that if this intervention resulted in a sizable depreciation of the dollar, the inflationary consequences could be viewed as inconsistent with the Committee's long-run policy of achieving price stability.

In further discussion of an appropriate course for monetary policy, the Committee took account of a staff analysis which suggested that, on the assumption of unchanged conditions of reserve availability and steady interest rates, M2 growth would moderate somewhat over the balance of the year from its rapid pace in recent months; nonetheless, growth of this aggregate would continue to be supported to some extent by the lagged effects of earlier declines in market interest rates on the opportunity costs of holding M2 balances, and on a cumulative basis M2 was projected to rise somewhat further within the lower half of the Committee's range for the year. The expansion of M3 was expected to continue to be damped, though to a reduced extent, in the fourth quarter by further reductions in the assets and M3 liabilities of under-capitalized thrift institutions and by RTC outlays that substituted in part for managed liabilities in M3; by year-end, this aggregate was projected to be a little above the lower bound of the Committee's range. The pickup in the growth of money and reserve aggregates since around mid-year and the projected expansion of the broad money aggregates within the Committee's ranges for the year were cited as welcome developments that were consistent with the Committee's overall policy objectives.

In the Committee's consideration of possible adjustments in the degree of reserve pressure during the intermeeting period, a majority of the members supported a proposal to adjust operations more readily toward some easing than toward any firming. In the view of these members, the risks to the expansion were more heavily weighted toward a shortfall from current expectations than toward faster growth and greater inflationary pressures. Members who preferred a symmetrical instruction generally saw the risks to the economy as more evenly balanced and some observed that the present dollar situation warranted extra caution before any easing was undertaken; however, a bias toward ease would not involve any change from the current directive and most of these members indicated that they could accept such an instruction.

It was noted in further discussion that seasonal borrowing was likely to drop in the weeks ahead, so that a declining total of adjustment plus seasonal borrowing would be associated with a given degree of reserve restraint and a given federal funds rate. It was understood that, subject to the Chairman's review, the necessary technical reductions in borrowing objectives would be made during the intermeeting period.

At the conclusion of the Committee's discussion, all but two of the members indicated that they preferred or could accept a directive that called for maintaining the current degree of pressure on reserve positions and that provided for giving particular weight to potential developments that might require some slight easing during the intermeeting period. Accordingly, slightly greater reserve restraint might be acceptable during the intermeeting period, while some slight

lessening of reserve restraint would be acceptable, depending on progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated by the Committee were expected to be consistent with growth of M2 and M3 at annual rates of around 6-1/2 percent and 4-1/2 percent respectively over the three-month period from September to December. The intermeeting range for the federal funds rate, which provides one mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded, was left unchanged at 7 to 11 percent.

At the conclusion of the meeting, the following domestic policy directive was issued to the Federal Reserve Bank of New York:

> The information reviewed at this meeting suggests that economic activity continued to expand at a moderate pace in the third quarter. In July and August, total nonfarm payroll employment rose appreciably despite the depressing effect of strike activity. The civilian unemployment rate remained around 5-1/4 percent. Industrial production picked up in August, mainly because of a rebound in auto assemblies and coal mining. Consumer spending has registered larger gains in recent months, reflecting in part a surge in auto sales. Housing starts in July and August were slightly above their second-quarter average. Indicators of business capital spending suggest somewhat slower growth in the third quarter after the substantial increase in the first half of the year. The nominal U.S. merchandise trade deficit recorded a further decline in July relative to June and to the average for the second quarter as a whole. Sharp reductions in energy prices over the summer months damped increases in consumer prices and contributed to declines in producer prices. The latest wage data suggest no change in prevailing trends.
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> Interest rates generally show small mixed changes on balance since the Committee meeting on August 22. In foreign exchange markets, the trade-weighted value

of the dollar in terms of the other G-10 currencies fell after the release of the G-7 statement on September 23; on balance, the dollar depreciated somewhat over the intermeeting period.

M2 grew fairly briskly in August and evidently also in September, lifting its expansion thus far this year to somewhat above the lower end of the Committee's annual range. M3 grew at a substantially reduced pace in this period, as assets of thrift institutions and their associated funding needs apparently contracted further; for the year to date, M3 has grown at a rate around the lower bound of the Committee's annual range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives, the Committee at its meeting in July reaffirmed the ranges it had established in February for growth of M2 and M3 of 3 to 7 percent and 3-1/2 to 7-1/2 percent, respectively, measured from the fourth quarter of 1988 to the fourth quarter of 1989. The monitoring range for growth of total domestic nonfinancial debt also was maintained at 6-1/2 to 10-1/2 percent for the year. For 1990, on a tentative basis, the Committee agreed in July to use the same ranges as in 1989 for growth in each of the monetary aggregates and debt, measured from the fourth quarter of 1989 to the fourth quarter of 1990. The behavior of the monetary aggregates will continue to be evaluated in the light of movements in their velocities, developments in the economy and financial markets, and progress toward price level stability.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Taking account of progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, slightly greater reserve restraint might or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of M2 and M3 over the period from September through December at annual rates of about 6-1/2 and 4-1/2 percent, respectively. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period

before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 7 to 11 percent.

Votes for this action: Messrs. Greenspan Corrigan, Angell, Johnson, Keehn, Kelley, LaWare, Melzer, and Syron. Votes against this action: Mr. Guffey and Ms. Seger.

Mr. Guffey favored an unchanged policy for the period ahead, but he dissented because he could not support a directive that was biased toward easing during the intermeeting period. He remained concerned that the rate of inflation would continue to be undesirably high.

Ms. Seger dissented because she felt that some easing of monetary policy was desirable at this time. In her view developments in manufacturing, notably in the motor vehicles sector, along with potential softness in capital expenditures, housing construction, and exports signaled a weaker overall economy. In the circumstances, she believed that an easier monetary policy was needed to help sustain the expansion and that such a policy would be consistent with continuing progress in reducing the rate of inflation.